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Financial Markets

Irving Trust

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Economic Research &
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Friday
(Noon)

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The Fed continues to pursue its policy of being relatively restrictive with reserves. It has gotten control of the aberrant technical factors of recent weeks. Now it is overshooting its borrowing targets early in the week and injecting excess reserves on Wednesday, the last day of the Fed's statement week. This approach is underscored by the Fed's doing reserve-adding System RPs on Wednesday of each of the last two statement weeks. From these late-in-the-week operations, we must conclude that the Fed has come as close as is possible to its true net borrowed target: approximately $450 million, based on last week's results. The Fed has kept control of its net borrowed target even though this has meant some increased variability in the Fed funds rate. One result of this is to make small movements in the Fed funds rate less meaningful to the market. Thus attention has come to be focused more on M1's behavior and the Fed's next move.

This re-emphasis on M1 is important because M1 is no longer billions of dollars over the top of its growth range. With M1 now about $2.3 billion below the top of the new range, the market has become very dependent on the weekly outlook for money growth--more so than earlier this year. The new, mid-year, M1 growth bands of 5% to 9% represent a very narrow target: In mid-August, it's $5 billion wide; at end-December, it's $12.5 billion wide. Therefore even weekly developments in money growth can dramatically alter the position of M1 relative to its boundaries--and money growth is unpredictable. So far this year, 34% of the weekly changes in M1 have been greater than $3.0 billion; last year, 21% were greater than $3.0 billion. So M1 has become even more volatile this year than last. Thus, chances are pretty good that the money supply will bounce around erratically within--and possibly above--the target from now until the end of 1983. Much of this action will be unanticipated: The consensus forecast of money market economists this year has been a very poor guide to actual changes in M1.

The market is now focused on M1. The Fed, taken at its word, is more concerned with M1's velocity. Thus the Fed will gear its net borrowed target to account for velocity's performance. Even if M1's growth slows, the Fed will not necessarily let rates fall because velocity might be on the rise. A strong economy is likely to keep the Fed somewhat restrictive because fast GNP growth would likely be associated with an increase in velocity. Moreover, the Fed is likely to be most restrictive if M1 is over its target because money growth is not irrelevant. Yet, the M1 target is so narrow it will be hard to be sure how fundamentally strong or weak M1 really is, unless we get a dramatic change in M1's behavior. Because the market will anticipate the Fed's reaction, we may be in store for increased year-end interest rate volatility, driven by the market's inability to predict M1. The Fed will remain restrictive until the economy shows some signs of real weakness. Depending on where money is relative to its growth range, "restrictive" will mean different things.

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Market Yields

	9/9/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.63	9.63	10.00
Repurchase Agreements	9.50	9.45	9.75
U.S. Treasury Issues			
Bills			
3 months	9.42	9.60	8.69
6 months	9.91	10.13	10.36
1 year	10.31	10.59	11.25
Coupons			
2 years	10.87	11.18	12.02
4 years	11.39	11.66	12.68
7 years	11.68	11.97	12.78
10 years	11.71	12.01	12.64
Long Bond	11.71	11.98	12.34
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.40	9.50	10.50
3 months	9.50	9.70	10.80
6 months	9.80	10.15	11.70
1 year	10.25	10.45	12.25
Banker's Acceptances			
1 month	9.35	9.50	10.20
3 months	9.60	9.85	10.70
6 months	9.85	10.15	11.75
Eurodollar Deposits			
1 month	9.88	10.00	11.50
2 months	10.00	10.18	11.75
3 months	10.13	10.38	12.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.40	9.53	10.04
1 month	9.45	9.59	10.22
3 months	9.74	9.87	10.54
Bank Holding Companies			
1 month	9.19	9.19	10.22
Dealer Placed:			
3 months	9.70	9.71	9.87
New AA Corporate Utility Bond	12.90	13.00	14.30
Tax Exempt			
6 month Project Notes	5.60	5.65	5.25
1 year AAA Bond	6.00	5.70	6.75
5 year AAA Bond	7.10	7.00	8.00
20 year AAA Bond	9.30	9.30	10.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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